

#S-14

**signed 8-3-04
IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS**

In Re:

**JAMES ARTHUR OTTE,
ROSANN GAY OTTE,**

DEBTORS.

**CASE NO. 03-23696-7
CHAPTER 7**

SUNFLOWER BANK, N.A.,

PLAINTIFF,

v.

ADV. NO. 04-6007

JAMES ARTHUR OTTE,

DEFENDANT.

**ORDER DENYING MOTION TO DISMISS BASED ON
THE CURRENT STATE OF THE EVIDENCE**

This proceeding is before the Court on the defendant's motion to dismiss.

Defendant-debtor James Arthur Otte ("Debtor") appears by counsel Carl R. Clark.

Plaintiff Sunflower Bank, N.A. ("Bank"), appears by counsel Terry D. Criss. The Court has reviewed the relevant materials and is now ready to rule.

FACTS

On a motion to dismiss, the Court must accept as true the plaintiff's allegations and reasonable inferences that might be drawn from them. This description, then, views

the facts in the light most favorable to the Bank. Some of the facts are established by pleadings filed the main bankruptcy case, rather than in this adversary proceeding.

The Debtor is the majority shareholder and president of a company called Sunflower Services, Inc. (“Company”), that held an inventory of fertilizer and chemicals. As of June 2003, the Company owed the Bank around \$1,850,000 as a result of some loans, leases, and credit card charges, all secured by the inventory. The Debtor personally guaranteed the Company’s debts to the Bank. He also caused the Company to give the Bank regular reports of the quantity and value of its inventory.

In July 2003, apparently based on the Bank’s application, a Kansas state court appointed a special master to take control of the Company, and the Company was placed into receivership the next month, on August 21. On that date, the receiver reported that the Company’s inventory had a cost value of about \$1,194,000, but that he had not been able yet to determine the viability of many of the chemicals or their actual value. On the following December 11, the receiver submitted a written report to the state court in which he stated that the Company’s fertilizer and chemical inventory had been mislabeled, watered down, contaminated, and misrepresented; its actual value was about \$38,000. The Bank contends that the Debtor fraudulently caused the value of the Company’s inventory to be overstated to the Bank, and that in extending credit to the Company, the Bank reasonably relied on the inventory reports.

The Debtor filed a Chapter 7 bankruptcy petition on September 2, 2003, listing the Bank as one of his creditors. The first meeting of creditors was set for September 25, so the deadline for filing complaints under 11 U.S.C.A. § 523(c) objecting to the dischargeability of certain types of debts was November 24, 2003. The Bank received proper notice of this deadline. Nevertheless, the Bank did not file its complaint seeking a determination that the Debtor's alleged fraud excepted its debt from his discharge until January 15, 2004. The Bank contends that it had no knowledge of the Debtor's alleged fraud before it got the receiver's December 11 report.

DISCUSSION

Debts resulting from a debtor's fraud can be excepted from a Chapter 7 discharge under § 523(a)(2)(A) of the Bankruptcy Code. However, § 523(c)(1) provides that such debts are discharged "unless, on request of the creditor to whom such debt is owed, and after notice and a hearing, the court determines such debt to be excepted from discharge" under § 523(a)(2)(A). No statute sets any deadline for the creditor to seek such a determination, but Federal Rule of Bankruptcy Procedure 4007(c) does, specifying that a complaint under § 523(c) must be filed no later than 60 days after the first date set for the meeting of creditors under § 341(a). The Court notes that Bankruptcy Rule 4004(a) sets an identical 60-days-after-the-first-meeting deadline for filing a complaint under § 727(a) objecting to a Chapter 7 debtor's discharge. Each Rule provides that the Court

can extend its deadline on a motion filed before the deadline has expired.¹ Rule 9006(b)(3) provides that the Court can enlarge the time for taking action under these Rules only to the extent and under the conditions stated in them.

The Debtor asks the Court to dismiss this proceeding because the Bank missed the Rule 4007(c) deadline. The Bank does not question that it missed the deadline, but contends that equitable tolling should apply to excuse the late filing of its complaint. The Court must decide whether equitable tolling is available to extend the deadline.

In a 1996 decision, *European American Bank v. Benedict (In re Benedict)*, the Second Circuit noted that courts had reached different conclusions about whether the time limit set by Rule 4007(c) was “jurisdictional” or could be extended retroactively under some circumstances.² Some courts had held that bankruptcy courts had no jurisdiction to consider complaints filed after the expiration of the deadline.³ Others, including the Tenth Circuit, had allowed a late-filed complaint when the bankruptcy court had set an incorrect deadline.⁴ Finally, other courts had held that bankruptcy courts could extend the time to file a complaint to determine dischargeability after the

¹Fed. R. Bankr. P. 4004(b) & 4007(c).

²90 F.3d 55, 53-54 (2d Cir. 1996).

³90 F.3d at 53-54 (discussing *In re Kirsch*, 65 B.R. 297 (Bankr. N.D. Ill. 1986) and citing other cases following its holding).

⁴90 F.3d at 54 (citing *In re Themy*, 6 F.3d 688, 690 (10th Cir. 1993), and other cases).

Rule 4007(c) deadline had expired, “if equity so require[d].”⁵ The Second Circuit agreed with this last group, and ruled that Rule 4007(c)’s deadline is subject to waiver, estoppel, and equitable tolling.⁶

Earlier this year, in *Kontrick v. Ryan*, the Supreme Court similarly ruled that the time limit set by Rule 4004 for filing complaints objecting to a debtor’s discharge was not jurisdictional, and the debtor could forfeit the right to assert the untimeliness of the creditor’s complaint by failing to raise the question until the bankruptcy court had ruled against him on the merits of the complaint.⁷ The Court pointed out that the courts of appeal had divided on the question whether Rules 4004 and 4007(c) allowed equitable exceptions, but declined to reach that question because the debtor’s possible forfeiture of the limitations defense did not concern any equity-based exception.⁸ Nevertheless, *Kontrick* makes clear that the time limits set by these Rules are not “jurisdictional” in the sense that the debtor can always raise them at any time (even after losing on the merits) to defeat a late-filed complaint. In other words, the first category of cases the Second Circuit had described in *Benedict* has been overruled.

⁵90 F.3d at 54.

⁶90 F.3d at 54.

⁷540 U.S. ___, 124 S.Ct. 906, 157 L.Ed.2d 867, 880-82 (2004).

⁸*Id.* at ___ & n. 11, 124 S.Ct. at ___ & n. 11, 157 L.Ed.2d at 880-81 & n. 11.

In other contexts, the Supreme Court has indicated that statutory filing deadlines are generally subject to the defenses of waiver, estoppel, and equitable tolling.⁹ A leading treatise on federal procedure explains that a statute of limitations may be avoided under “the doctrine of equitable tolling, which halts the running of the limitations period so long as the plaintiff uses reasonable care and diligence in attempting to learn the facts that would disclose the defendant’s fraud or other misconduct. Obviously, the most appealing motivation for the application of the doctrine is when the plaintiff’s ignorance of her rights results from some form of deception by the defendant.”¹⁰ The Bank alleges that the Debtor was responsible for the Company’s false reports about its inventory, and that the Bank did not learn of this fraud until the receiver submitted his report in the state court proceedings, after the Rule 4007(c) deadline had passed. The Court believes that if the Bank’s allegations are determined to be true, they would probably establish that the Rule 4007(c) deadline should be tolled, at least in the absence of other evidence indicating that the Bank should have discovered the fraud soon enough to have filed a timely complaint.

The Court notes that another facet of the Bankruptcy Rules also suggests that the deadlines set by Rules 4004 and 4007(c) should not be applied to foreclose all equitable exceptions. Rule 9024 provides that Civil Rule 60 applies in bankruptcy cases, with

⁹See, e.g., *United States v. Locke*, 471 U.S. 84, 94 n. 10 (1985) (citing *Zipes v. Trans World Airlines, Inc.*, 455 U.S. 385, 392-98 (1982)).

¹⁰4 Wright & Miller, *Fed. Prac. & Pro.: Civil 3d* § 1056 at 255 (West 2002).

certain exceptions that are not relevant here. The time limits of Rules 4004 and 4007(c) concern the commencement of litigation, while Rule 60 authorizes a court to grant a party relief from a judgment entered at the completion of litigation. Among other things, Rule 60(b)(3) provides that relief may be granted for “fraud . . . , misrepresentation, or other misconduct of an adverse party.” Since fraud and misrepresentation can provide the basis for relieving a party from a final judgment in bankruptcy cases, it seems logical that they can also — under appropriate circumstances, of course — provide a basis for excusing a party’s delay in filing a complaint to commence litigation in bankruptcy cases.

CONCLUSION

For these reasons, the Court concludes that the Debtor’s motion to dismiss must be denied, based on the current state of the record. Depending on the evidence that is ultimately presented, the Court might or might not decide that the Bank’s delay in commencing this proceeding should be excused. For now, though, the Court is convinced that the Bank’s allegations are sufficient to defeat the motion to dismiss.

IT IS SO ORDERED.

Dated this _____ day of August, 2004.

DALE L. SOMERS
BANKRUPTCY JUDGE

CERTIFICATE OF SERVICE

The undersigned hereby certifies that true and correct copies of the above **ORDER DENYING MOTION TO DISMISS BASED ON THE CURRENT STATE OF THE EVIDENCE** were mailed via regular U.S. mail, postage prepaid, on the ____ day of August to the following:

Carl R. Clark
Lentz & Clark
PO Box 12167
Overland Park, KS 66282
Attorney for Defendant-Debtor

Terry D. Criss
Hampton & Royce, L.C.
PO Box 1247
Salina, KS 67402-1247
Attorney for Plaintiff

Vicki Jacobsen
Judicial Assistant